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EX PARTE OR LATE FILED

PACIFIC  **TELESIS**
Group-Washington

August 9, 1995

EX PARTE

William F. Caton
Acting Secretary
Federal Communications Commission
Mail Stop 1170
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Dear Mr. Caton:

Re: *GEN Docket No. 90-314 - Amendment of the Commission's Rules to Establish
New Personal Communications Services*

Yesterday, Betsy Granger, Attorney, and Steve Aspell, both of Pacific Bell Mobile Services; Sherry Herauf, Director, Pacific Telesis, and I met with Michael Wack, Deputy Chief, Policy Division, Wireless Telecommunications Bureau. Please associate the attached material with the above-referenced proceeding.

We are submitting two copies of this notice in accordance with Section 1.1206(a)(1) of the Commission's Rules.

Please stamp and return the provided copy to confirm your receipt. Please contact me should you have any questions or require additional information concerning this matter.

Sincerely,



cc: Michael Wack

Enclosures - 3

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COST ALLOCATION AND AFFILIATE TRANSACTIONS

AUGUST 8, 1995

COST ALLOCATION AND AFFILIATE TRANSACTIONS

- **COST ALLOCATION STANDARDS REFLECT A FULLY DISTRIBUTED COSTING METHODOLOGY (Joint Cost Order, para. 2)**
- **ALL COSTS OF PCS SERVICE ARE SEPARATED FROM OTHER COSTS OF PACIFIC BELL BECAUSE PCS IS PROVIDED BY A WHOLLY OWNED SUBSIDIARY, PACIFIC BELL MOBILE SERVICES**
- **THEREFORE, ONLY AFFILIATE TRANSACTIONS RULES ARE RELEVANT.**

COST ALLOCATION AND AFFILIATE TRANSACTIONS

- **SECTION 32.27 SETS FORTH THE AFFILIATE TRANSACTION RULES ADOPTED IN THE JOINT COST ORDER**
- **IF THERE IS NO TARIFF OR MARKET PRICE, SERVICES PROVIDED TO PBMS BY PACIFIC BELL ARE PROVIDED AT FULLY DISTRIBUTED COST.**

COST ALLOCATION AND AFFILIATE TRANSACTIONS

- **AN ATTRIBUTABLE COST METHOD OF FULLY DISTRIBUTING COST IS USED: OVERHEAD COSTS ARE ALLOCATED IN PROPORTION TO THE COSTS THAT CAN BE DIRECTLY ATTRIBUTED TO THE VARIOUS SERVICES.**

Joint Cost Order, para. 113.

COST ALLOCATION AND AFFILIATE TRANSACTIONS

- **TIER 1 LECs MUST FILE COST ALLOCATION MANUALS (Joint Cost Order, para. 47)**
- **PACIFIC BELL'S AND NEVADA BELL'S COST ALLOCATION MANUALS WERE APPROVED IN 1988 (AAD 7-1692, January 19, 1988, para. 3)**
- **SUBSEQUENT AMENDMENTS RELATING TO SERVICES PROVIDED BY PACIFIC BELL TO PACIFIC BELL MOBILE SERVICES AND PACIFIC TELESIS MOBILE SERVICES WERE FILED WITHOUT OBJECTION.**

AFFILIATE TRANSACTIONS FCC COST ALLOCATION PROCESS

Background

Whenever a non-tariffed service is provided by Pacific Bell to one of its affiliated companies (or vice-versa), an affiliate transaction occurs. The process for identifying, calculating, and reporting the amounts associated with transactions from Pacific to one of its affiliates is described below.

Process Overview

An agreement is reached between Pacific and an affiliate about the nature and scope of service to be provided, frequency, how the primary expenses are identified, and other terms and conditions.

Primary expenses are identified via time/expense reporting to tracking codes, and/or via special studies. Sometimes the directly identified time/expense reporting amounts are allocated between the affiliate's proportion and Pacific Bell's proportion. The allocation method varies based on the service provided or work group involved.

The Transfer Pricing/Affiliates Group (TPAG) identifies and gathers all primary expense information for booking and billing.

TPAG calculates then books the primary expense amounts with a unique tracking code.

The Corporate Accounting Safeguards System (CASS) picks up the affiliate transaction primary expense amounts based on its tracking code and computes the fully distributed cost following Part 64 Rules and the methodology described in Pacific Bell's Cost Allocation Manual (CAM).

Direct and fully distributed affiliate transaction amounts are removed from total company results of operation prior to the jurisdictional separations process (i.e., the amounts are not included in the subject to separations amount).

Specific Example: Service Representative

Pacific Bell Mobile Services (PBMS) contracts with Pacific Bell for Service Representatives to sell PBMS products and services.

Since it is not practical for Service Reps to directly report their time when working with PBMS products, a statistical special study is performed to identify the average amount of time a Service Rep spends handling a call related to PBMS products.

The Transfer Pricing/Affiliates Group (TPAG) calculates the wage amounts associated with the services provided by the Service Reps. Monthly volumes of PBMS product orders multiplied times the average PBMS time from the special study results in total PBMS time. Next a ratio of total PBMS time divided by total service rep time is calculated. This ratio is then applied to the monthly total service rep wage amount, local supervision salaries, and miscellaneous non-labor expenses. Social security and benefit loadings are applied to the wage amounts to determine total primary expenses.

AFFILIATE TRANSACTIONS FCC COST ALLOCATION PROCESS

Specific Example: Service Representative, continued

The total primary expense amounts are then booked to a unique tracking code (3xx) associated with the affiliate (for example, PBMS's affiliate transaction tracking code is 35X).

The Corporate Accounting Safeguard System (CASS) is Pacific Bell's Part 64 Cost Allocation process. Monthly, CASS reads a file from the General Ledger system which contains summarized transaction amounts for all expense accounts. It uses the unique 3xx tracking code to identify the affiliate transactions.

CASS assigns the primary expense amounts to the "Affiliate Transaction Directly Assigned" bucket, and calculates the fully distributed costs (FDC) in accordance with Part 64 Rules and procedures specified in Pacific's Cost Allocation Manual (CAM), Section VI.

The resulting direct and FDC affiliate transaction amounts are removed from total company operations prior to the jurisdictional separations process (Part 36).

Service Rep Salaries - Account 6612 (Sales)

1. Direct Costs identified by tracking code are put in the "Sales - Directly Assigned Regulated" cost pool.

2. Joint costs/overheads are applied to direct costs by cost pool logic

e.g., Sales - Salary Related Costs are attributed to regulated and nonregulated in the same proportion as directly assigned and attributed wages and salaries within Sales (Account 6612)

3. After going through the original Part 64 fully distributed cost pool logic to ensure that fully distributed costs associated with the direct sales costs have been identified, the Total Regulated portion of the books is again run through the Part 64 process, this time to identify on a fully distributed cost basis those regulated Sales costs that are affiliated transactions to be booked based on FDC. These costs are then removed from ratemaking since the company is made whole (and earns a return on investment) from the affiliate transaction and not the ratepayers. Only Regulated, non-affiliate transaction costs are subject to the Separations process and included in ratemaking.

PART 64 HIERARCHY

Directly Assigned	Regulated	Nonregulated
Directly Attributable	Regulated	Nonregulated
Indirectly Attributable	Regulated	Nonregulated
General Allocator	Regulated	Nonregulated



Part II

Cost Allocation Rules, Part 64

Cost Allocation Rules

- **Govern allocation of company costs between regulated and nonregulated activities (Part 64)**
- **Govern amounts recorded on telco books for affiliate transactions (Part 32)**

History

- **Cost allocation rules were one of the nonstructural accounting safeguards adopted in CI-III, allowing BOCs to offer enhanced services on an unseparated basis.**
- **Detailed cost allocation and affiliate transaction rules were adopted in the Report and Order in CC Docket No. 86-111, Released February 6, 1987.**

Goals and Purposes

- **Guard against cross-subsidy/protect ratepayers from costs and risks of nonregulated ventures.**
- **Maximize availability of efficient, low-cost services of all kinds**

Cost Allocation Standards

- **Fully Allocated Costing**
- **Maximize Direct/Indirect Attribution**
- **Costing Principles**
 - **Tariffed Services at Tariff Rates**
 - **Direct Assignment**
 - **Common Costs**
 - 1. **Direct Attribution**
 - 2. **Indirect Attribution**
 - 3. **General Allocation**

Affiliated Transactions Hierarchy

Services

If tariffed, use tariff rate

else

If a substantial third-party market exists, use market price

else

Use fully distributed cost.

Assets

If tariffed, use tariff rate

else

If a substantial third-party market exists, use market price

else

Regulated → Nonregulated = Higher of Cost or FMV

Nonregulated → Regulated = Lower of Cost or FMV

Cost Allocation Controls

- CAM filed with FCC
- Accounting process follows CAM
- ARMIS reports filed with FCC
- External audit performed annually

Cost Allocation Manuals

- **Content**
 - **Description of nonregulated activities**
 - **List of incidental activities**
 - **Chart of affiliates**
 - **Nature of affiliate transactions**
 - **Cost categories and assignment/allocation procedures by account/subaccount**
- **All companies follow common format.**
- **Updates filed quarterly with 60-day implementation wait.**

Incidental Activities

- **Regulated Activities**
- **Quantitative Limit**
 - **No more than 1% of total revenues**
- **Qualitative Guidelines**
 - **Specified in Cost Manual**
 - **Non-line-of-business**
 - **Traditional treatment**

Chart of Corporate Affiliates

- **Show all corporate affiliates**
- **Include business organizations under common ownership**
- **Can also provide brief description of affiliates**

Transactions With Affiliates

- **Describe Transaction with Affiliates**
 - **Nature**
 - **Terms**
 - **Frequency**
- **Format and content will vary by company**

Cost Pools

- **Homogeneous Groupings**
- **Disaggregate based on service performed**
- **Level of disaggregation depends on**
 - **Complexity**
 - **Materiality**
 - **Availability of functional cost information**

Apportionment of Costs

- **Apply apportionment methods**
- **Meet FCC Objectives**
 - **Maximize Direct Assignments**
 - **Define meaningful causal measures to attribute high proportion of common costs**
 - **Allocate unattributable costs**

Cost Categories

- **Directly Assignable**
- **Directly Attributable**
- **Indirectly Attributable**
- **Unattributable**

Directly Assignable Costs

- **Definition**

- The cost of **assets and resources** incurred *exclusively* for providing either regulated services or nonregulated activities.

- **Examples**

- **Regulated -- Salary of Tariff Analyst**
- **Nonregulated -- CPE Inventory**